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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of:	)	
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1998 Biennial Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers	)	CC Docket No. 98-137
	)	
Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, *et al.*	)	CC Docket No. 99-117
	)	
GTE Telephone Operating Companies Release of Information Obtained During Joint Audit	)	AAD File No. 98-26

COMMENTS OF GTE

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COMMENTS OF GTE

GTE Service Corporation and its affiliated domestic telephone operating companies[1] (collectively, "GTE"), respectfully submit their comments on the Further Notice of Proposed Rulemaking ("FNPRM") in the above-captioned proceeding.[2] GTE commends the Commission for seeking to "evaluate the conditions under which our existing depreciation rules may be eliminated or changed for all price-cap carriers."[3] For the reasons discussed herein, GTE supports deregulation of depreciation rates and specifically urges the Commission to permit ILECs participating in the CALLS plan to

[1] GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE South Incorporated, GTE Southwest incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

[2] FCC 00-119 (rel. April 3, 2000).

[3] FNPRM, ¶ 3.

amortize the difference between financial and regulatory depreciation reserves over five years on an above-the-line basis, in accordance with the proposal set forth in the March 3, 2000 joint *ex parte*.[4] That proposal will fully protect consumers and advance the Commission's pro-competitive objectives.

I. INTRODUCTION

In the FNPRM, the Commission proposes to "evaluate the conditions under which our existing depreciation rules may be eliminated or changed for all price-cap carriers,"[5] while seeking "to assure that any changes in depreciation practices do not adversely impact consumers and competition."[6] The FNPRM arises out of a joint *ex parte* filed by GTE, Bell Atlantic, BellSouth, and SBC, which requested a waiver of the Commission's depreciation requirements for ILECs that: (1) use the same depreciation factors and rates for federal regulatory and financial accounting purposes, (2) submit information concerning their depreciation accounts when significant changes to depreciation factors are made, (3) amortize the difference between reserve balances on their regulatory and financial books over a five-year period, and include the amortization expense "above the line," (4) commit not to seek an increase in rates for the amortization expense in their interstate access rates through a low-end adjustment,

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[4] Letter from Frank J. Gumper, Bell Atlantic Network Services, Robert Blau, BellSouth Corporation, Donald E. Cain, SBC Telecommunications, Inc., and Alan F. Ciamporcero, GTE Service Corporation, to Mr. Lawrence Strickling, Chief, Common Carrier Bureau, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, filed March 3, 2000.

[5] FNPRM, ¶ 3.

[6] *Id.*

an exogenous adjustment, or an above-cap filing, and (5) commit not to seek an increase in rates at the state level for the increased interstate amortization expense.[7]

GTE strongly supports deregulation of depreciation rates and above-the-line amortization of the gap between the interstate regulatory and financial depreciation reserves based on the joint *ex parte*. Given the rapid introduction of new technology, the growth of local competition, and the prospect of fundamental access charge reform, continued use of artificial, prescribed depreciation lives for regulatory purposes is untenable. The commitments made by GTE and other ILECs, in the context of adoption of the CALLS plan,[8] assure that ratepayers and competition will be fully protected after the elimination of depreciation regulation. They also obviate the need for continued, routine reporting of costs under alternative write-off scenarios and of information about depreciable plant accounts. Consequently, GTE urges the Commission to adopt new depreciation policies for carriers that satisfy the conditions set forth in the joint *ex parte*.

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[7] *Id.*, ¶ 10 (summarizing joint *ex parte*). Specifically, the joint *ex parte* suggested changes to the waiver showing set forth in the December 30 Report and Order in CC Docket No. 98-137 (FCC 99-397) ("Depreciation Reform Order").

[8] The Joint ILEC ex parte of March 3 was made in the context of the CALLS proposal. If adopted, CALLS would establish a time path for ILEC interstate rates over the next five years that reflects a reasonable balancing of various interstate issues. The ILECs' proposal did not address (and was not intended to address) any intrastate depreciation deficiency , or any related intrastate issues.

II. DEPRECIATION REGULATION SHOULD BE ELIMINATED IN CONJUNCTION WITH IMPLEMENTATION OF THE CALLS PLAN.

A. The ILECs' Commitments Protect Ratepayers and Advance the Commission's Policy Goals.

The Commission asks whether the proposed five-year, above-the-line amortization of the difference between regulated and financial book costs, combined with commitments not to seek increased rates for the amortization, "adequately protects consumers from adverse rate impacts and otherwise meets the policy goals of the *Depreciation Order*."[9] The answer, indisputably, is yes.

With respect to protection of consumers, the commitment not to seek increassed rates for the amortization through the low-end adjustment mechanism, an exogenous cost adjustment, or the filing of above-cap rates eliminates any possibility that the amortization could produce an increase in interstate access rates.[10] The low-end adjustment could continue to be used only if an ILEC suffered unreasonably low earnings for reasons unrelated to the amortization. Moreover, because the amortization amount will be clearly reflected on the ILEC's books,[11] there is no risk that an LFAM claim that in reality seeks an increase in rates for the amortization amount

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[9] FNPRM, ¶ 12.

[10] In footnote 25, the Commission similarly asks "whether there is a firm commitment with regard to both state and interstate with respect to any recovery of any portion of the amortization." Neither GTE nor any other ILEC will be writing anything off the books on the intrastate side; there is nothing about the interstate adjustment that would affect any intrastate revenue requirement.

[11] *See* Section II.D, below.

could be made under another pretense.[12] In addition, the Commission never has treated depreciation changes as subject to exogenous treatment,[13] and the standard governing above-cap filings is so rigorous that there is no chance that an ILEC could slip through an amortization-related price increase.[14]

Nor does the proposed amortization and above-the-line treatment implicate the Commission's policy goals of assuring cost-based UNE rates.[15] The amortization itself will not directly affect UNE rates because, under current FCC rules, those rates must be based on forward-looking cost studies, which will not include amounts related to the amortization. Compliance with this commitment can be easily audited, given the explicit accounting treatment of the amortized depreciation deficiency noted above and described more fully in section II.D, below.[16]

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[12] In any event, GTE notes that the depreciation changes sought by the ILECs will actually reduce the chance of a low-end adjustment. GTE's financial reporting rates, which will be used for the new interstate depreciation rates, are lower than existing interstate depreciation rates. Moreover, ILECs participating in the CALLS plan have committed not to seek any LFAM adjustment in the first year, and the Commission's pricing flexibility rules would eliminate any recourse to the LFAM company-wide once an ILEC is granted flexibility in any study area. *See* Access Charge Reform, Fifth Report and Order, CC Docket No. 96-262, FCC 99-206 (rel. Aug. 27, 1999), at ¶¶ 160-168.

[13] Depreciation Reform Order, ¶ 64.

[14] *See* 47 C.F.R. § 61.49(d) (1999). Notably, no ILEC has ever sought, let alone been granted, authority to make an above-cap filing.

[15] *See* Depreciation Reform Order, ¶¶ 28-29.

[16] In section II.E, below, GTE explains that the Commission should not continue to set depreciation ranges for the purpose of UNE and universal service cost studies. That issue, however, is separate from the direct effect of the amortization and above-the-line treatment on UNE rates and high cost support.

B. Above-the-Line Treatment of the Amortized Expenses Is Consistent with Sound Accounting Principles and FCC Precedent.

The Commission asks whether "it is appropriate ... to include the amortization amount in the calculation of regulated earnings in the carriers' reports to the Commission." It also inquires (1) what "protections, if any," will ensure that reported earnings are not used in applications for rate increases, and (2) whether price-cap ILECs should be "required to periodically report costs that reflect what their costs would have been had the write-off been taken as a one-time below-the-line event or maintain records that reflect the amortization factored-in and factored-out ...."[17]

As explained below, above-the-line treatment of the amortized expenses is not only "appropriate," but is the only approach that is consistent with sound accounting principles and related Commission precedent. In addition, there is no need for any "protections" to assure against applications for rate increases.

1. The Amortization Properly Should Be Included as an Expense Offsetting Regulated Earnings.

It is black-letter accounting that expenses should be matched to the related revenues. Consequently, the purchase of equipment that will be used to generate revenue for several reporting periods should be capitalized as an asset and expensed over the reporting periods during which it is used to produce revenue, not expensed in the period when the equipment was purchased. In accordance with this principle,

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[17] FNPRM, ¶ 13.

GAAP allows for equipment to be assigned an estimated life. Other things being equal, the longer the estimated life, the less depreciation expense is booked in any one year.

The Commission's prescribed life ranges are uneconomically long, particularly given dramatic advances in technology and growing local exchange competition. As a result, the depreciation expense booked by the ILECs does not accurately reflect the current, sharply diminished value of much of their equipment, creating a depreciation reserve deficiency and overstating the book value of the equipment. Bringing the regulatory depreciation accounts in line with financial accounts (which properly recognize the lower value of the equipment) requires that ILECs write off the difference; the joint *ex parte* proposed to do so over the five-year period during which the CALLS plan will transition to much lower switched access charges.

Above-the-line treatment of this write-off is appropriate because the amortized expenses should have been used to offset regulated service earnings in past years. Accounting for these sums below the line would result in a mismatch between expenses and revenues. That is, the revenues were properly recognized above the line, but only a portion of the related expenses received similar treatment. Unless all associated expenses (including the amortized deficiency) are likewise recognized above the line, then regulated earnings will continue to be overstated.

Such above-the-line amortization is consistent with Commission precedent. For example, in the late 1980s the Commission authorized recovery of the ILECs' then-existing depreciation reserve deficiency through above-the-line amortization over a five-year period. Notably, the Commission did so in a rate-base regulated environment, where – unlike the proposed amortization here – the amortization was directly recoverable through rates. In deciding to permit this above-the-line amortization, the Commission explained that:

> [S]o long as the present large reserve deficiency exists, carriers' rates will not accurately reflect the costs incurred in providing service. It is in the public interest to eliminate this mismatching of costs and rates as quickly as possible so that carriers and ratepayers do not make decision based on inaccurate data and assumptions. ... Because the LECs operate in a rapidly changing technological environment, we cannot be certain that the marketplace forces which the LECs may face in the future would permit recovery of their reserve deficiency at that time. It would not be prudent for us to ignore these potential risks when present conditions allow us to promptly eliminate the source of the problem.[18]

That logic holds equally true today, when implementation of the CALLS plan, combined with the ILECs' commitment not to seek an increase in rates for the amortization, affords the Commission and the industry a golden opportunity to eliminate the reserve deficiency without adversely affecting the ILECs, their competitors, or their customers.

The decision discussed in the preceding paragraph is far from the only instance when the Commission permitted above-the-line amortization of a depreciation reserve deficiency. In 1989, for example, the Commission permitted AT&T to amortize a reserve deficiency above the line and write down the affected assets on its financial books.[19] That decision is notable because it strongly implies that below-the-line

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[18] Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, 3 FCC Rcd 984, 987 (¶ 17) (1988). As the Commission further noted, the amortization "does not cause the carriers' recovery of depreciation expenses to differ in any way from traditional ratemaking practices. The issue here is simply the *timing* of recovery of costs associated with carriers' use of capital to provide a communications service." *Id.* at 988 (¶ 25).

[19] Prescription of Revised Percentages of Depreciation for AT&T, 4 FCC Rcd 1466 (1989); *see also* Prescription of Revised Percentages of Depreciation for GTE, 4 FCC Rcd 1148, 1149 (1989) (permitting GTE North-Missouri to amortize its depreciation

(Continued...)

treatment would be proper only if the assets no longer were used and useful. AT&T's request was triggered by increasing competition in the long distance market; and the Commission expressly recognized that "the plant subject to a write down has not been removed from service."[20] The Commission's decision to permit AT&T to reflect the write-down in above-the line accounts thus reflects the reality that the Commission could not then (for AT&T) and cannot now (for the ILECs) continue to guarantee a revenue stream sufficient to recover investments made in a monopoly environment. There is, accordingly, ample precedent for the proposed above-the-line amortization in the instant case.

2. No Reporting Requirements or Additional Protections Are Needed To Prevent Rate Increases As a Result of the Amortization.

There is no need for any reporting requirements or other "protections" to assure against applications for rate increases. As GTE explained in section II.A, above, the commitment not to seek increased rates for the amortized expenses through the LFAM mechanism, an exogenous cost adjustment, and above-cap rates exhausts the possible avenues for raising rates under the price cap rules. Sealing the case against any additional protections is the fact that the amortized expenses will be plainly indicated on the ILECs' books and readily auditable. If an ILEC makes a request for an LFAM or exogenous cost adjustment for other reasons, or if it files for above-cap rates, the

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(...Continued)
reserve deficiency).

[20] 4 FCC Rcd at 1468 (¶ 16).

Commission can seek and obtain whatever supporting information is needed (included recalculated earnings) to assure that the request would not recover any of the amortized expenses. Layering on additional reporting requirements would impose unwarranted and substantial burdens on ILECs.

C. Above-the-Line Treatment of the Amortized Expenses Will Properly Reflect Earnings.

The FNPRM asks "whether a five-year amortization accounting treatment has an adverse impact on reported earnings, and if so, what, if any, action the Commission should take to address these impacts."[21] Including the amortization expenses in regulated accounts will assure that the reported earnings reflect real economic costs. In the past, ILEC earnings have been overstated as a result of using uneconomic depreciation lives. Accordingly, while the inclusion of the amortized expenses above the line likely will depress reported earnings compared to past years, this is not an "adverse" effect that requires regulatory intervention. Rather, it is an inevitable byproduct of moving from a system that intentionally deferred costs beyond the useful lives of the underlying assets to a system that accords with sound accounting principles. No Commission action is needed because, as explained above, the participating ILECs have committed not to seek recovery of the amortized expenses.

[21] FNPRM, ¶ 13.

D. The Amortization Process Can Be Tracked Through Accounting Entries.

The FNPRM asks what measures the Commission should take to "account for and monitor the proposed amortization process."[22] The only measure necessary is to require that the adjustment be consistent with the Commission's past treatment of amortized reserve deficiencies. Specifically, the difference between the Part 32 regulatory net books and the financial books should be debited to Account 3100.9000 (Accumulated Depreciation - Reserve Imbalance). The offsetting credit should be posted to the accumulated depreciation of the individual plant accounts (Accounts 3100.XXXX) with appropriate Field Reporting Codes. For each year of the five-year amortization period, one-fifth of the total reserve adjustment will be credited to Account 3100.9000 with a corresponding, above-the-line debit to expense account 6561.2400 (Amortization of Depreciation Reserve Imbalance). This treatment allows for the adjustment of the net book value of the individual plant accounts for purposes of computing depreciation factors and rates, but decreases total net book value over the amortization period as the expense is recognized.

E. Continuing To Prescribe Ranges of Depreciable Life Is Unnecessary and Counter-Productive.

In the Depreciation Reform Order, the Commission decided to "continue to maintain realistic ranges of depreciable life and salvage factors for each of the major plant accounts" to be "relied upon … for determining the appropriate depreciation

[22] FNPRM, ¶ 13.

factors to use in establishing high cost support and interconnection and UNE prices."[23] To that end, the Commission required ILECs to submit information regarding forecast additions and retirements for major network accounts, replacement plans for digital central offices, and relative investments in fiber and copper cable.[24] Implicitly assuming the continued need for Commission-prescribed life ranges, the FNPRM seeks comment on the "timing of the carriers' data submissions ... and the scope of such submissions that will be needed to periodically update depreciation factors for use in the cost models."[25]

GTE opposes continued reliance on Commission-prescribed depreciable life ranges for any purpose. Those ranges assume, contrary to fact, that regulators can predict the economic value of an investment in telecommunications plant at some point in the future based on a snapshot of ILEC practices and plans at a specific moment in time. In reality, regulatory forecasts of the rate at which an asset's economic value will decline inevitably are overtaken by unanticipated technological change. Indeed, if the Commission's useful life ranges were valid, there would be no discrepancy between the ILECs' regulatory and financial books and no need for the relief contemplated in the FNPRM.

The fact that some states rely on the existing depreciation ranges in conducting TELRIC studies is not a reason to continue prescribing such ranges in the future. The

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[23] Depreciation Reform Order, ¶ 34.

[24] *Id.*

[25] FNPRM, ¶ 14.

economic depreciation schedules used by the ILECs in their financial reports are sound enough to justify writing down billions of dollars in plant. Of necessity, then, those schedules must be sound enough to use in cost models for determining UNE rates or the costs of providing universal service. There is no risk that the ILECs would manipulate their depreciation rates for financial reporting purposes in order to achieve regulatory gains; the financial depreciation schedules already are in place, and tampering with those schedules would create reporting gyrations that neither the Securities and Exchange Commission nor Wall Street would soon accept.[26]

In contrast, retaining prescribed depreciation ranges based on the snapshot approach would assure that the assumptions underlying UNE and USF cost studies are proven wrong over time. Such a gap between the predicted and actual economic lives of ILEC assets would violate the Commission's rules, which require the use of "economic" depreciation rates in calculating the forward-looking costs of interconnection and UNEs.[27] A depreciation rate is economic only if it permits the ILEC to accommodate technological change and competitive pressures without regard to artificial regulatory constraints on its decisions to write off the value of existing plant.

In short, the Commission should allow ILECs to use financial depreciation lives, which reflect true economic depreciation, for cost study purposes. Consequently,

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[26] Moreover, the Commission itself has recognized that prescribed depreciation rates are inappropriate in a competitive market, where business decisions are governed by economic depreciation rates. *See* Price Cap Performance Review for Local Exchange Carriers, Access Charge Reform, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, FCC 97-159, at ¶ 152 (rel. May 21, 1997).

unless there is another legitimate reason to mandate reporting of data concerning the ILECs' depreciation accounts, such a requirement is needlessly burdensome and singularly uninformative. If the Commission nonetheless decides to require submission of plant data, it should do so only on an as-needed basis and should obtain that information from all carriers, not just ILECs. Including data from companies that have not historically been subject to depreciation regulation will help produce results that are more consistent with intensifying competition.

III. THE CONTINUING PROPERTY RECORD AUDITS ARE MOOT.

The FNPRM asks "whether an accounting treatment that results in a non-recoverable amortization of a substantial portion of a carrier's investment provides a legitimate basis to terminate the CPR audits."[28] As the Commission knows, GTE strongly believes that those audits were poorly conceived and executed, methodologically faulty, and a tremendous waste of the Commission's and the carriers' resources.[29] However, even if the results obtained by those audits were valid, which they are not, the combination of the rate reductions that will occur under CALLS and the write-downs that will occur in order to close the gap between regulatory and financial depreciation render those audits irrelevant. The Commission should take no

(...Continued)
[27] 47 C.F.R. § 51.505(b)(3).

[28] FNPRM, ¶ 15.

[29] *See* Comments of GTE, CC Docket No. 99-117, ASD File No. 99-22, filed Sept. 23, 1999, Reply Comments of GTE, CC Docket No. 99-117, ASD File No. 99-22, filed Oct. 25, 1999.

further action with respect to the CPR audits and should refrain from pursuing future audits of other ILEC property records.

IV. CONCLUSION

For the foregoing reasons, the Commission should deregulate depreciation rates and permit above-the-line amortization of the difference between the ILECs' financial and regulatory depreciation reserves under the conditions proposed in the joint *ex parte*.

Respectfully submitted,

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